A Work Project, presented as part of the requirements for the Award of a Masters Degree in Management from the Faculdade de Economia da Universidade Nova de Lisboa.

Acquisition of Carrefour-Portugal by Sonae Distribuição

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A Project carried out on Strategy, with the supervision of:

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June 12th, 2009

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Abstract

This study centers on the subject of mergers and acquisitions by describing and analyzing the case-study of the acquisition of Carrefour Portugal by Sonae Distribuição. The main objectives of this study are to identify the reasons underlying the decision, to examine how the acquisition fits Sonae Distribuição's strategy, and to analyze how the integration process is conducted and affects the value created by the acquisition.

This case study clarifies that growth through value creation was the main reason behind Sonae's decision of acquiring Carrefour-Portugal. The acquisition would allow Sonae to reinforce its position as number one in the Portuguese retail market and enlarge its market coverage. Moreover, the acquisition would boost the organic growth of the different business formats of the company. Economies of scale and scope, dimension gains and combination of complementary resources, namely creating stronger product and store portfolios and integrating competences that neither one could achieve alone, are the main potential synergies identified that enabled Sonae to achieve its objectives.

The analysis demonstrates that the value created by this deal derives from the strategic fit of the acquisition, considering the strategic pillars of Sonae Distribuição, creating a unique resource complementarity. On the other hand, a successful post-acquisition integration process was conducted. The main aspects identified for this successful process were the effective communication with every stakeholder, the cooperative environment established between the companies from the beginning, and the celerity of the process. Critical aspects such as familiarity with the sector and culture similarity were favorable to the deal, representing a remarkable fit. The complete integration within a single company allowed for the realization of the main synergies that motivated the deal, despite the adverse economic conjuncture.

Key Words

Strategic Management; Mergers and Acquisitions; Synergies; Integration.

INTRODUCTION

Mergers and acquisitions (M&A) have been one of the most widely used strategies by companies in their attempt to enhance their value creation potential. M&A allow for firms to react to new challenges and opportunities and, if done properly, may result in an increased market share, profitability and enterprise value. Paradoxically, a large amount of failures have been registered. Difficulties in realizing the desired synergies inherent to the acquisition and successfully integrating the companies are the main aspects pointed out for these failures. The existing literature has identified the lack of attention to the strategic fit and to the integration process as the main causes for failure.

These aspects make this a rather interesting subject to study: what leads a company to take a decision of acquiring another one, which aspects contribute for the potential value creation and which actions should a company take to effectively convert those potential synergies in actual value.

To better understand the reasoning behind an acquisition, a case study approach was applied. This project will therefore center on the analysis of the acquisition of Carrefour-Portugal by Sonae Distribuição in the Portuguese retail sector. This case study comprises several characteristics that make this an important case to analyze. On the one hand, it has retailing as its background, a sector where M&A are commonly used as strategies to grow by creating value. Moreover, it takes place in Portugal, a mature market where M&A are giving their first steps. On the other hand, the case study appears to be a successful one, despite being very recent and thus not allowing for definitive conclusions to be drawn yet.

The information contained in this case study was obtained from five main sources: books, scientific journals, internet research, media and interviews with managers of Sonae Distribuição. Data from 2006-2007 was mostly used, as it was the most suitable one to analyze the market and the companies' situation before the acquisition. On the other hand, in some cases it was not possible to obtain more recent data. As retailing is a highly competitive sector, firms are very concerned about keeping some information private, especially quantitative data.

The project is divided in two parts. The first one presents the case study, as well as the profile of the companies involved, their strategies, and the background of the retailing industry, with a particular emphasis on the Portuguese case. The second part contains the subsequent case analysis, where the rationale behind the acquisition is analyzed and the decision is framed within the recent literature on M&A. The economic and strategic motivations for the acquisition are evaluated and the integration process is analyzed. The case analysis ends with a brief summary of the rationale behind the deal and the first results obtained.[1]

[1] The exhibits presented are essential to the comprehension of the case. The appendixes at the end of the project aim to complement the information presented in the project as well as the information contained in some exhibits.

PART I – CASE STUDY

"In this accelerated market, there's always going to be winners and losers. Right now, it is Sonae who is winning. The Carrefour deal is a clinical striker's goal. Jordão's style."

In Jornal de Negócios[2]

"I'm totally convinced that this operation that joints Sonae Distribuição and Carrefour-Portugal will belong to the minority group of cases that create value."

- Nuno Jordão, CEO of Sonae Distribuição[3]

1. Introduction

In mid-2007, news regarding Carrefour's decision of selling its operations in Portugal disturbed the Portuguese retail sector. Despite the majority of the analysts considering the French Group Auchan as the most likely winner of this race, all doubts were cleared on July 26th: Sonae Distribuição won the bidding, buying Carrefour's Portuguese operations for an enterprise value of 662 million Euros. The deal included Carrefour's 12 hypermarkets and 8 petrol stations, as well as the 13 licenses for new commercial spaces that the French group had already obtained. The deal excluded, however, the discount network Minipreço, also controlled by Carrefour.

On December 27th the competition authority announced its decision of not opposing to the deal, requiring however remedies in six markets identified as having a risk of dominant position creation or reinforcement (Viana do Castelo, Coimbra, Paços de Ferreira/Penafiel, Porto, Montijo/Barreiro/Seixal, and Portimão). These remedies included the elimination of 32,000 sqm of sales area, 15,000 sqm in alienations to competitors and 17,000 sqm in sales area reduction (actual or licensed). The company was also barred from requesting licenses for expansions, modifications or new openings for one year in these markets. Although these restrictions amount to about 19% of the total acquired area, they are mainly concerned to the food segment, and could therefore be used by Sonae to install its non-food brands.

In the beginning of 2008, less than a month later, the acquisition process was concluded and the Carrefour banner was replaced by *Continente* (Sonae's hypermarket brand). Nuno Jordão, CEO of Sonae Distribuição, pointed out: "In two days we changed the back-office and front-office systems, reclassified 120 thousand products, registered all the suppliers. (…) It was amazing the way the integration of Carrefour's 3 thousand employees in Sonae Distribuição was done"[4], and adds, "everything was conducted smoothly and no problems arose the following days (…) and, in contrast with what typically happens, there was a sales increase instead of a decrease".[5]

[2] Pedro Santos Guerreiro, "O 'hat-trick' de Jordão", *Jornal de Negócios* 30 Jul. 07.
[3] Sonae Distribuição, *Correio da Distribuição*, nr. 106.
[4] Nuno Botelho, "Portugal fica saturado em 2010", *Público – Economia* 8 Mar. 08.
[5] Sónia Peres Pinto, "Mudança de Carrefour para Continente devia ser «case study»", *Agência Financeira* 19 Feb. 08

With this deal, Sonae strengthened its position as the largest retailer in Portugal, with a market share of about 30% (statically), reinforcing its distance towards the 2nd player, Jerónimo Martins (19%), and obtaining the leadership in a new regional market, Braga. The acquisition was seen as the first consolidation move of the Portuguese retail sector.

The acquisition deal was associated to an enterprise value (EV)/Sales transaction multiple of 1.25x[6], which is considered by Millennium BCP's Investment Bank analysts as higher than the typical multiple for retail players (Sonae Distribuição was valued with an EV/Sales multiple of 0.87x). Even so, these analysts, along with BPI's Investment Bank analysts, considered that it was possible for Sonae to achieve the necessary synergies to make this a profitable deal if a 0.4% increase in EBITDA margin was accomplished.[7]

2. Retail Sector

Retailing is usually the sector that generates higher sales volumes and employment in any economy, being valued at 5 billion dollars globally. The profitability of the sector depends on the population growth and consumer preferences.

The introduction of new retail formats (supermarkets and hypermarkets) changed the way retailing is done and created a scale advantage for retailers at the expense of manufacturers (Exhibit 1). The increasing lack of differentiation between retailers made price the main competitive factor, shrinking the sector's profit margins. As a result, retailers put an effort on obtaining high sales volume and operational efficiency to enhance profitability. Therefore, retailers have been using M&A as a way to enlarge their operating capability (to obtain synergistic cost savings and higher bargaining power, and reach the minimum scale required to compete at a global level) and to expand to foreign markets. To give an example, the Top 10 global retail players account for almost 30% of the Top 250 players' sales and in Europe the Top 30 players are expected to generate 71.5% of global sales in 2009.[8] (Appendix 1)

The consumers' focus on price and their higher level of information created another trend in retailing: private labels. Labeled under the retailer brand, these products are usually cheaper due to lower costs with marketing, distribution and economies of scale in production. These products also represent an opportunity to differentiate from competitors and create a relationship with consumers. Since consumers link the retailer's brand with the retailer's own brand products, this represents an opportunity to enhance consumer loyalty and retailer brand

[6] Carrefour's Enterprise Value = 662M€; Sales of Carrefour in 2006 = 530M€. Source: Millennium BCP, *Newsletter de Investimentos*, Nr. 54, 30 Jul. 07

[7] "Quatro razões por que a compra do Carrefour é positiva para a Sonae", *Jornal de Negócios* 27 Jul. 07; Cátia Almeida, "Sonae espera converter Carrefour em Continente ainda este ano", *Diário de Notícias* 3 Aug. 07

[8] Luís Aragão, "Concentração marca retalho europeu", *Hipersuper* 17 Mar. 06

image by taking advantage of the "umbrella effect" [9]. Private labels also give retailers the power over every decision in the value chain, entirely controlling their final offers.

Manufacturers are the ones who lose the most: in addition to the increase in retailers' dimension and consequent bargaining power, they have to compete with private labels and deal with the reduction in the number of suppliers and branded products bought by retailers. This fact has further intensified the competition at producers' level and explains why many suppliers decided to produce retailers' private labels.

2.1. The Portuguese Case

Unlike what usually happens in other countries where at least one of the global Top 30 retailers is the market leader, the Portuguese retail sector is led by two national chains (Sonae Distribuição and Jerónimo Martins) (Exhibit 2). In 2006, Sonae Distribuição was the market leader (3,526M€), followed by Jerónimo Martins (1,948M€) and Intermarché (1,654M€[10]). *Minipreço* and *Pingo Doce* were the players with the highest number of stores and *Modelo* led in sales area (Exhibit 3). With a business volume of approximately 14,127 million Euros[11], retailing is a very dynamic sector, especially the food segment with an annual growth rate of 4.1% in revenues and 6% in sales area. (Appendix 2)

Evolution of retail formats – following the modernization path

With the introduction of the first hypermarkets in Portugal in the late 80s, the Portuguese retail sector suffered a change in its structure. During the 90s, traditional retailers lost their dominance to supermarkets and mostly to hypermarkets, whose market share increased from 5.4% in 1987 to 42.4% in 1995.[12] (Appendix 3)

After the year 2000 the dominance of hypermarkets started to slow down. The low economic growth, high level of families' debt and unemployment prompted a contraction in private consumption (Appendix 4). As a consequence, consumers' behavior changed: in-house food consumption increased (especially fresh products) while clothing, fuel, household and out-of-home food consumption decreased, and consumers became more price-oriented. These changes created a gap in the market that was soon seized by discount chains (Appendix 5). The success and expansion of this format led many players to rethink their strategies, offering private labels, creating discount chains or adopting an *every-day-low-price* strategy. To provide an example, Jerónimo Martins completely changed the positioning statement of *Pingo Doce* from a high-end target to a soft discount chain, based on location proximity and focused

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[9] Consumers accept new products just because they have the same brand. Consumers are willing to try new products since they remember good previous experiences with products with the same brand.
[10] José António Rousseau, *Manual de Distribuição*, 2008.
[11] 2007 INE data, considering both food and non-food retailers.
[12] Cátia Almeida, "Hipers perdem negócio para supermercados", *Diário de Noticias* 19 Jul. 06

on fresh products and private labels. This repositioning increased even further the pressure on low prices across the market.

The new commercial licensing law approved in 2004 contributed to the slackening of the restrictions in the attribution of new commercial space licenses (blocked since 2001). Still, the benefits were not extended in a large measure to hypermarkets. This was due to the pressures made by traditional retailers to limit the expansion of large dimension formats, and also due to the difficulty in establishing larger formats in markets with significantly high installed sales area. Furthermore, stores with more than 2,000 sqm were required to close on Sundays and holidays in the afternoons, which negatively affected their revenues.

As a result of these restrictions and changes in consumers' preferences for proximity, smaller formats (supermarkets and discounts) have been benefiting from a higher expansion pace. As José Silva Ferreira, former president of APED[13], states: "People are going back to proximity supermarkets and focusing their shopping on food. They are coming back to the essential, which limits the introduction of larger stores".[14] (Exhibit 4)

Despite this apparent unfavorable forecast for hypermarkets, the level of hypermarket penetration in Portugal is still low (150,000 people per hypermarket) when compared with Spain (110,000) or France (50,000).[15] (Exhibit 5) Therefore, unexplored opportunities might still be available in the market for this format.

Private Label – a new opportunity

Following the global trend, private labels have also been gaining market share in Portugal. Despite presenting a low volume when compared to the European average, these products have registered a considerable increase in sales (12.9% in 2005 to 20.05% in 2007). (Appendix 6) The association of low prices to low quality seems to have been overcome as well as the idea that private labels are cheap imitations of branded products.

Retailers have been including private labels in their portfolio as strategic pillars, in order to control the value chain, increase their bargaining power over suppliers and obtain higher profit margins. In fact, private labels' growing acceptance has allowed retailers to increasing the final price, twice more than branded products. [16] To reinforce their brand, retailers offer a large range of private labels, divided in several price categories, from *premier-prix* products to products with similar quality to branded ones but at lower prices, or even gourmet products. Moreover, they entered unexplored niches and are starting to surpass branded products in terms of innovation.

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[13] APED - Portuguese Association of Retail Companies
[14] Lúcia Crespo, "Entrevista distribuidores vs. produtores", *Jornal de Negócios* 25 Nov. 08
[15] Luís Aragão, "O poder do discount". *Hipersuper* 10 Jan. 06
[16] "Supermercados aumentam preço dos produtos brancos", *Diário de Notícias*, 8 Dec. 08

Diversification trend: non-food retailing

The number of non-food retail chains (category killers) has also grown over the last few years (23% of the sector in 2006 vs. 20% in 2004), offering a high diversity of products in a single category at low prices (e.g., apparel, electronics, toys, sports goods, etc.). Despite many players being specialized in a given non-food retail segment, some of them are also big food-retail players. Actually, according to APED, non-food retailing is led by Sonae Distribuição, with *Worten* on the lead with 478 million Euros in sales in 2008.

The fast growth of these formats may be explained by several factors. First, the food-retailing market is nearing saturation, especially in big cities, so its profitability and growth are likely to slow down in the following years. Hence, non-food retailing appears to be the solution for retailers' sustainable growth in the long-run, diversification of their risk and capitalization of their consumer base to other stores of the group. Second, commercial licensing law is not as strict as in food retailing, with the expansion of category killers being easier to obtain than in food retailing. Third, category killers present high levels of profit potential. To give an example, these formats led 2006 and 2007 APED profitability rankings (Appendix 7).

Growth and concentration

Competition in retailing is expected to intensify in the following years, with the supply surpassing the demand level even further. Average store density, despite being already high is still below the European mean, which predicts a continuous growth. The level of retailers' concentration is also still low when compared with other European markets (Exhibit 6). A study conducted by Roland Berger highlights the fact that in the majority of product categories there is a higher level of producers' concentration than retailers'.[17] Despite this, the growing number of players and stores has intensified competition, and the success of some players occasionally leads to the acquisition of others. M&A represent the easiest way to grow, especially concerning hypermarkets, whose growth is limited by stricter legal constraints and already represent a mature market (usually characterized by lower growth rates).

3. Companies Profile

3.1. Carrefour

Founded in France in 1960, Carrefour is the largest retail chain in the world in terms of size and the second largest retailer in revenues, with annual sales of approximately 102 billion Euros in 2007. Its operations are located mainly in Europe, Latin America and Asia, with over 15,000 stores located in a total of 30 countries. Carrefour was the first one to create the

[17] "A evolução da concentração da indústria e da distribuição em Portugal". Roland Berger's study for APED. 16 Mar. 09 <http://www.aped.pt/pdf/APED_Conferencia_Imprensa.pdf>

concept of hypermarkets: "the concept was entirely new – 'everything under one roof' in a self-service environment – and it was an overwhelming success with customers."[18]

To overcome the restrictions in new hypermarket openings in France, Carrefour soon started to expand its operations abroad, organically and through M&A. The main expansion move took place in 2000, with the merger with Promodés (another French retailer), which converted the company into a heavy global player.

Despite being global, Carrefour acts mainly locally, adapting its stores and products to the different markets and locations. Around 90% of the products on shelves come from national suppliers. Products are only bought through the central purchasing unit when it is more profitable than buying locally. Carrefour also uses a decentralized structure to better adapt and react to opportunities and threats in each location. Each store is free to undertake decisions regarding product-mix, purchases, positioning, and objectives achievement. Headquarters are mainly responsible for long-term strategy decisions and global financial and technical issues.

The French group entered Portugal in 1991, through the acquisition of two Euromarché hypermarkets. In 2007, Carrefour was operating in Portugal under 2 banners: Carrefour–Portugal (hypermarkets) and Minipreço (discount chain). Exhibit 7 illustrates the situation of Carrefour–Portugal before the deal. It was an important player, with stores in key locations. The retailer was seen by consumers as having a high variety of products and brands, good quality fresh products, and an aggressive pricing policy in some categories (Exhibit 8). It offered different products from competitors, namely private labels and gourmet products.

The divestment decision arose as a consequence of the rationalization strategy implemented in 2005 by the new CEO José Luis Durán, in response to the disclosure of poor financial results. To achieve the objective of annual sales growth of 6-8% and increase profits, Carrefour decided to invest only in the most profitable countries, where the group has a dominant position, and dispose of non-strategic or underperforming markets where the objective of being an industry leader was unattainable. The company's priorities are therefore (1) France, (2) Spain, Belgium and Italy (Carrefour's 'G4' countries), and (3) the emerging countries, mainly BRIC countries (Brazil, Russia, India and China).

Despite the increasing financial results, Portugal did not represent a strategic market for Carrefour (about 0.6% of total net sales).[19] Still, the main reason behind the divestment decision was the position of Carrefour–Portugal in the retail market ranking (7th). The fierce competition, changes in consumers' preferences towards smaller and proximity formats and the legal restrictions to hypermarket operations made the achievement of a leading position unattainable, prompting the divestment decision.

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[18] "At a Glance 2007", <http://www.carrefour.com>

[19] Raquel Almeida Correia, "Retalho – Porque é que o Carrefour se vai embora", *Público–Economia* 27 Jul. 07

3.2. Sonae Distribuição

Sonae Distribuição is the retail branch of Sonae, one of the largest Portuguese private groups. Founded in 1985 as the result of a joint-venture between Sonae and Promodés, Sonae Distribuição was the first company to introduce the hypermarket concept in Portugal, changing the way retailing was done in the country and the Portuguese consumption habits. It was an unknown reality in Portugal at the time, and the strategic alliance provided an opportunity for Sonae to obtain know-how from Promodés (the 2nd largest retailer at the time) in terms of sector knowledge and its experience in the already developed French market, namely competences on sales management and information systems. The alliance allowed Sonae to benefit from its large scale and create a strong brand in hypermarkets – *Continente*.

The following years were marked by the expansion, diversification and improvement of Sonae's operations. The company expanded its portfolio, introducing smaller and non-food formats. The need to grow also prompted the company to expand the food segment to Brazil in 1995, an investment that was withdrawn by the company ten years later due to "difficulties in presenting higher profit levels than the cost of capital invested in this market".[20]

When Carrefour merged with Promodés in 1998, Sonae Distribuição found itself in an uncomfortable situation, with Carrefour owning 22.37% of its equity and at the same time being an important competitor. This situation dragged on until 2004, when Sonae bought Carrefour's rights to the company and took the stocks of the company out of the stock market to avoid similar situations in the future.

In 2007, Sonae Distribuição was the number one player in both food and non-food retailing, generating annual sales of 3.4 billion Euros and covering 70% of the Portuguese population. (Exhibit 9 summarizes Sonae Distribuição's situation before the deal). At the time, food retailing represented about 70% of its revenues and its food brands led the ranking of brand strength in retailing done by Marktest (Appendix 9). *Continente*, its main brand, had been considered the retailer in which Portuguese people place the most confidence since 2003.

4. Sonae's Way

"I want unthinkable investment plans." - Paulo Azevedo, CEO of Sonae SGPS[21]

"Numbers illustrate the profile of Sonae Distribuição, i.e., a company designed to grow!"- Nuno Jordão[22]

From the beginning, Sonae Distribuição relied on three main strategic pillars:

- **Growth:** In a constant effort to reinforce its leadership position in the Portuguese retail sector, Sonae Distribuição tried to exploit all growth opportunities, either organically or

[20] Sonae SGPS report to CMVM. <http://www.agenciafinanceira.iol.pt/noticia.php?id=622304&main_id=>
[21] Victor Jorge, "Afinal alguém quis o Carrefour", *Hipersuper* 27 Aug. 07
[22] Sonae Distribuição, op. cit., p. 4.

through M&A. Therefore, the company has been registering a growth in the opening of new stores and sales area. Besides, the company analyzes the existing opportunities to implement new business concepts that can boost its growth objectives. The main basic concept of the company's growth plans is the attainment of synergistic gains from resources and internal competences, namely economies of scale and scope (in management, logistics and information systems for instance), market know-how and channeling their consumer base to new stores. Additionally, expansion to new regional markets and foreign markets is considered whenever the return on investment is expected to be positive.

- **Efficiency**: To obtain higher operational margins, Sonae Distribuição puts a lot of effort on constantly enhancing its business efficiency. Operational efficiency programs in areas such as infrastructure logistics, information systems, inventory management optimization and store operations are frequently implemented, with the objective of achieving more effective cost controls and productivity gains. Employees also receive training in areas such as operational service, customer knowledge, and technical competencies to enhance this efficiency. On the other hand, Sonae Distribuição's centralized structure and logistics also represent a source of efficiency gains. Since the company operates mainly in Portugal, the market dimension and considerable homogeneity allows the company to rely on central warehouses and central purchasing units, and to centralize its decision-making procedures in the headquarters.
- **Innovation**: The company tries to create a competitive advantage based on innovative solutions, transversely applied to every brand and to every store. The client is the starting point of every new solution and the company tries to anticipate its consumers' expectations, without forgetting their efficiency concerns. To enhance innovation, Sonae Distribuição relies on programs that stimulate stakeholders to develop new ideas that can improve the company. Over the last years, the company developed new business formats and innovative private label products for each format. Logistics (e.g., voice-picking system), management models (e.g., category management), services (e.g., online store, insurance), store spaces (e.g., gourmet area) and customer relationship programs (e.g. self-checkouts, loyalty card) are also areas where innovation has been a constant.

4.1. Code Name: Growth

While paying attention to organic growth, both Paulo Azevedo (CEO of Sonae SGPS) and Nuno Jordão (CEO of Sonae Distribuição) believe that the Portuguese retail sector is in a consolidation phase and that the company's future expansion relies on acquisitions in any retail format to overcome the legal constraints of new openings and smooth competition.

Referring to the food segment, Nuno Jordão remarks that "by the end of the decade we can say that the Portuguese market will be saturated. That is why we decided to focus our investment efforts in Portugal".[23] This means that the opportunities to dominate the Portuguese market will vanish until the end of the decade, being all acquisitions with a value creation potential 'now-or-never-opportunities' to grow. Non-food segments' expansion is also included in the company's investment plans, with the opening of nearly 100 stores between 2006 and 2007 and the internationalization of some brands to Spain.[24]

Portugal still presents a lower level of retailing concentration than the EU average, which represents an opportunity for Sonae Distribuição to expand its sales base in its home country and avoid a reinforcement of the competitors' position. Thus, the company is "aware of possible acquisition opportunities that might allow for the reinforcement of its business competitive positions".[25]

5. The Acquisition

"The decision of doing this investment is based on the attractiveness of the assets, quality and competence of Carrefour-Portugal's human resources and on the certainty that, in a highly attractive and dynamic market such as the Portuguese retail distribution sector, Sonae Distribuição will be in a better position to enhance Portuguese consumers' satisfaction levels, both in terms of aggressive pricing policies and variety and quality of the products and services offered".

Nuno Jordão, CEO of Sonae Distribuição, during the Carrefour acquisition press conference[26]

In July 2007, and after some negotiation rounds, Sonae Distribuição reached a deal with Carrefour for the acquisition of its Portuguese operations for a value of 662M Euros, adding to its food operations portfolio of 105 *Modelo* stores (187,000 sqm) and 19 *Continente* stores (162,000 sqm), the 83,000 sqm of Carrefour.

For Sonae Distribuição, the acquisition of Carrefour–Portugal was carried out for several reasons. First, there was the fit between Carrefour's and Sonae's store portfolio. The deal only included hypermarkets, which were similar to *Continente* stores, revealing a high operational similarity and complementing its product portfolio. Second, the acquisition represented an opportunity for Sonae to reinforce its market leadership in the food segment. Sonae Distribuição was the leader with a 25% market share, followed closely by Jerónimo Martins with 19% (which could easily represent a threat to Sonae's position in the case their acquired Carrefour's operations). With this acquisition, Sonae Distribuição would also prevent the entrance of new foreign players that might be interested in entering Portugal. Third, Carrefour–Portugal was present in some important regional markets where Sonae had not managed to enter due to legal restrictions (namely Braga and Aveiro), representing the opportunity for the enlargement of its market coverage. Fourth, Carrefour's operations would

[23] Nuno Botelho, op. cit., p. 4.
[24] In mid-2008 the company entered in the Spanish market with *SportZone* and *Worten*.
[25] Victor Jorge, "Sonae Distribuição atinge 3,4 mil milhões", *Hipersuper* 21 Mar. 08
[26] "Sonae compra Carrefour em Portugal por 662 milhões", *Agência Financeira* 27 Jul 07

reinforce Sonae's growth due to the additional store space offered and also by adding to Sonae's portfolio licenses for new commercial spaces, contributing to the organic growth of the company. Fifth, there were many cost saving opportunities that could be achieved by integrating the operations and headquarters' functions of the companies.

The integration started to be planned in August, long before the competition authority's approval, in order to minimize the risk of failure. To ease the integration and build a stronger company, a multidisciplinary team with elements from both companies was created. The main objective was to guarantee that the integration of operations and stores was done in a quick and smooth way. Moreover, there was a special concern with effectively communicating all the decisions and implications of the deal to stakeholders, to prevent their resistance.

It was predictable from the beginning that the acquisition would result in a total integration of Carrefour's operations into Sonae Distribuição's structure, in order to exploit the potential synergistic gains that would result from their similarities and complementarities, and in the replacement of the Carrefour banner for *Continente*'s. Therefore, after the merger, each of the Carrefour stores was completely integrated in Sonae's store portfolio, adopting the same organization procedures and processes and losing a significant part of their previous decision-making power. From this point on, headquarters will make all the decisions regarding product portfolio and administrative functions, all orders are to be done through the central purchasing unit instead of directly to suppliers, deliveries are not to be done directly to the store but to central warehouses (where products are to remain in stock until they are needed in a store) and suppliers are common to all stores. This change allowed for a reduction of in-store storage space and consequently the conversion of that space in sales area. Hence, this space has been used to open new non-food stores, namely *Worten*, *SportZone* and *Modalfa* stores. Regarding administrative functions, Carrefour's large store-level structure (which included control and purchasing functions for instance) was replaced by Sonae's structure and Carrefour's employees were integrated into the existing departments at Sonae Distribuição's headquarters.

As far as commercial aspects are concerned, a product portfolio analysis of both companies was conducted, in order to identify the non-coincident product ranges and create a stronger portfolio. Carrefour was known for its exclusive products, namely gourmet and specialized products, and for good fresh products. Sonae Distribuição tried to incorporate into its portfolio those exclusive categories and replace the fresh products suppliers whenever Carrefour's ones offered higher quality products (e.g. meat). Carrefour also had a significant percentage of private labels on its product offerings, products that Sonae Distribuição also tried to incorporate whenever they were not in the portfolio. It is important to note that Carrefour-Portugal was integrated within a global retail chain, with a larger capacity to produce private labels than Sonae Distribuição, making it impossible for Sonae to incorporate all the private label suppliers. As a consequence of the deal, 10,000 new references were introduced. Miguel Rangel, Marketing Director of *Continente*, remarks: "It was a win-win process, not only in terms of integration but also of information and the scope that Carrefour had in its private-label. Not wanting to fail to our clients' expectations and deprive them from some products that Carrefour offered, we enlarged the assortment to include what *Continente*'s private label was not offering until now".[27]

During the merger, Sonae did not have to lay people off. One reason for that was the normal staff turnover rate, which could now be fulfilled with Carrefour's employees. On the other hand, Sonae Distribuição has predicted to create 2,000 to 3,000 jobs per year after the acquisition, preventing the need to lay off people. Some of the main top functions of Carrefour-Portugal were located in Spain (the regional headquarter), remaining a part of Carrefour after the deal. The duplicated functions were gradually eliminated and employees were allocated to their original departments (if possible) or to departments with growth needs. Nuno Jordão went to Carrefour-Portugal's offices himself to communicate the decision of maintaining all employees and to clarify people about their future tasks and positions within the new company. Meritocracy was the decision criteria for choosing who remained in the functions and who was transferred, in order to create a company that combines the best talents.

Customers also received special attention. According to Nuno Jordão: "We have clients in the center of our agenda. (…) From the first day, we will reinforce the levels of store service, especially in checkouts and service sections. In order to do that, we hired 575 new employees to make it easier for the client to see the improvement. (…) We created for each of the 12 stores a fortnightly brochure. In this brochure we are going to explain what we are doing, what is changing in the store and create, at the same time, mechanisms to allow the client to take part in our continuous improvement program".[28]

Carrefour's information systems as well as their financial and control instruments also had to be adjusted to the way these mechanisms worked at Sonae. To guarantee a successful adjustment, training was offered to the new employees and to Sonae's pre-acquisition employees (to help the integration of the new ones). Despite having adopted mainly Sonae's procedures, some Carrefour's policies were incorporated and new practices were adopted. To give an example, the key performance indicators were changed to accommodate the new company reality and part of the incentive system from Carrefour was adopted.

Faced with the smooth and fast way the integration was done, Nuno Jordão pointed out: "this process should be considered a case-study"[29], and added "today we are a single company with everyone doing their best to give to our wide customer base additional reasons for satisfaction".[30]

[27] Victor Jorge, "O Consumidor confia cada vez mais nas marcas próprias" *Hipersuper* 16 May 08
[28] Sonae Distribuição, op. cit., p. 4.
[29] Sónia Peres Pinto, op. cit., p. 4.
[30] Sonae Distribuição, op. cit., p. 4.

PART II – CASE ANALYSIS

This section is dedicated to the analysis of the case described in the previous section and tries to draw some conclusions from the data presented in the case description. The analysis will always have as basis the recent literature on M&A. Firstly, an analysis on the potential value creation of this acquisition is presented. Then, the strategic fit of the acquisition on the strategy of the acquirer is discussed. After that, the analysis follows on the post-acquisition integration process, in order to understand its contribution to potential value realization. To conclude, a brief summary of the rationale behind the deal is presented and discussed.

1. Synergies

Value creation is the basis of any firm's strategy (Besanko, et al., 2007). M&A are then used by companies with the same underlying purpose: to create value for stakeholders, i.e., synergies are the motive behind a company's decision to merge or acquire other companies. One can say that a synergy exists when the new firm's value is higher than the sum of the values of the two previous firms acting independently (e.g., Capron, 1999). Typically, the literature on the subjects identifies as main sources of synergies the improvement of operating efficiencies through economies of scale and scope, and the exchange of knowledge, capabilities and resources (e.g., Hitt, Ireland and Harrison, 2008; Capron, 1999). The acquisition of Carrefour-Portugal presents several opportunities to create value.

First of all, the acquisition represents an opportunity to expand Sonae Distribuição's market coverage and consequently sales and market share. This represents a crucial aspect in a sector where expansion is restricted by law. Market expansion is a central issue for any retailer to face the increasing price competition that characterizes the sector. To cope with diminutive margins, large sales volumes are the solution for survival. Moreover, the legal restrictions to growth limit the number of good locations (in terms of proximity, number of potential consumers, average consumer's income, etc.) where retailers can open stores. Therefore, this acquisition offers Sonae the possibility to integrate in the portfolio new privileged located stores that otherwise the company would hardly obtain.

The dimension increase that results from the acquisition also positively affects the bargaining power relative to suppliers of the company. With a market share of about 30% and the dominance of the hypermarket sector and some regional markets, it becomes even more important for suppliers to put their products in the shelves of this retail chain, being easier for Sonae to obtain better prices, payment conditions, fees, etc. This represents a central source of value creation, allowing the new company to increase its profit margins or to be better prepared than competitors to face a fierce price competition without damaging its profitability. Following the same underlying logic, better credit conditions with financial institutions can be obtained, a crucial factor for a company that is involved in a substantial growth plan.

The reconfiguration of its product-mix also represents a potential synergy, as pointed out by several authors (e.g., Kim and Finkelstein, 2009; Dranove and Shanley, 1995). The acquisition enables Sonae Distribuição to create a stronger portfolio in terms of variety and quality. This represents a kind of "cross-selling" effect, with Carrefour's exclusive products integrating Sonae's large store chain and having a wider distribution area. Moreover, the offering reinforcement usually has a positive impact on corporate image and reputation, which might lead to a larger consumer base than the sum of the two companies' consumers before the deal.

Another opportunity for potential value creation is related to the efficiency gains that can be obtained through economies of scale and scope. These gains also result from the scale enlargement, being the results even more visible in the ex-Carrefour operations as a result of the change in its structure. In logistics, it is possible to obtain saving on purchases, transportation and inventory management as a result of the higher turnover. Under the new organization, the former Carrefour stores will be less vulnerable to order volumes and suppliers deliveries, requiring lower levels of in-store inventory and having lower costs. As for marketing, the new firm will be able to save on advertising investments and on duplicated customer relationship programs. With about the same resources as before, Sonae can now obtain a larger advertisement reach. Human resources also represent an important area of cost cutting with the elimination of duplicated functions. This is even more noteworthy considering the decentralized structure on which Carrefour was based on, with several functions at a store-level that Sonae already centralized in headquarters. Those functions could, thus, be eliminated without requiring a significant increase of job positions in the headquarters.

Finally, in all business areas, knowledge synergies might come up with the sharing of knowledge and capabilities. One of the reasons behind the acquisition was precisely the quality of Carrefour's capabilities. As Nuno Jordão refers, "what is going to occur in this new company is a superior level of knowledge deriving from the new team". To give an example, it will be possible to integrate both companies' consumer database information, combining their market know-how and consumers insights, which represents a competitive advantage, especially considering Sonae's focus on innovation in private label and customer relationship.

In conclusion, Sonae Distribuição expects synergistic gains between 190 and 260 million Euros[31], as a result of economies of scale and scope and resources exchange, which corresponds to an operational cash flow increase of 0.5% in three years.

2. Strategic Fit

"We have the opportunity to combine distinct knowledge that exists in each team, allowing the new team to reach a superior level of know-how, a crucial aspect to consolidate the leadership position in the Portuguese market" – Nuno Jordão, CEO of Sonae Distribuição.

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[31] Paulo Moutinho, "Compra do Carrefour pode adicionar 9 a 14 cêntimos às acções da Sonae SGPS", *Jornal de Negócios* 31 Jul. 07

When analyzing the potential value created by an acquisition, one important concept must be kept in mind: strategic fit. Jemison and Sitkin (1986) define strategic fit as “the degree to which the target firm augments or complements the parent’s strategy and thus makes identifiable contributions to the financial and nonfinancial goals of the parent” (p.146). Despite being related to synergy achievement (analyzed in the previous section), this concept of complementarity is highlighted in the literature as crucial to the success of M&A (e.g. Harrison et al., 2001; Hitt, Ireland and Harrison, 2008).

Prior research (e.g., Grant, 1988; Lubatkin, 1987) has focused on firms’ similarities as the basis for value creation, based on economies of scale and similar competencies. However, recent studies (e.g., Hitt, Ireland and Harrison, 2008; Kim and Finkelstein, 2009; Harrison et al., 2001) defend that the existence of potential synergistic gains from similarities is not enough to guarantee the success of an acquisition. Superior value is created when firms have complementary resources because firms can combine their strengths in different areas, overcoming their vulnerabilities and shortage of resources, which results in a superior competitive advantage. In line with the resource-based view of the firm (e.g., Peteraf, 1993; St. John and Harrison, 1999), these authors highlight that the integration of complementary resources is more difficult to replicate by competitors, and thus, to compete against it, since it results in a unique combination of resources, and thus in private synergies. Private synergies are, therefore, defined in the literature as existing when “it is possible for two firms to combine their complementary resources in a way that creates more value that would any other combination of their resources” (Harrison et al., 2001, p. 394).

Given the emphasis that literature gives to this subject, it seems quite important to understand the reason why the acquisition of Carrefour-Portugal fits within the strategy of Sonae, namely by analyzing how this acquisition complements Sonae’s strategy, enabling it to create superior value. Despite some of the synergies identified in the previous section could have been achieved by other retailer who had bought Carrefour-Portugal, some of them could probably only be achieved by Sonae as a result of the complementary of resources between the firms.

First, in terms of geographical coverage, Carrefour’s operations fill in important gaps in Sonae Distribuição’s store portfolio that the company was not able to overcome alone due to legal constraints (namely Aveiro and Braga). One can say that the remedies imposed by the competition authority might indicate that the level of complementarity is limited. However, operating in a large range of retail concepts, Sonae was better-positioned to overcome the restrictions imposed on food sales area expansion than any other retailer (with limited business portfolios), by converting some food stores into non-food stores. Therefore, the acquisition fulfills Sonae’s growth needs in the food segment and boosts the expansion of non-food stores.

On the other hand, Carrefour’s exclusive products complement the already vast portfolio of Sonae. The gourmet and the high quality fresh products fit perfectly with the aspirations of Sonae to create a wider and stronger product portfolio, overcoming the existing flaws on those categories. Moreover, for Sonae, its private label was a 'must-invest' area: it could reinforce the image of *Continente* as a reliable and innovative brand, and offer advantages in terms of bargaining power and profit margins. Before the deal, the company was already considering the increase in weight of private label. Again, this acquisition matches Sonae's aspirations of creating a strong private label offering, integrating in the company not only their supplier network but also the embedded knowledge that Carrefour already had in this field.

As far as cost reduction is concerned, the dimension of Sonae Distribuição combined with Carrefour-Portugal creates a unique competitive advantage in terms of market leadership position. Therefore, the gains associated with economies of scale and bargaining power are potentially higher since the company now largely dominates the hypermarket sector in Portugal and is far ahead of its competitors in terms of market share.

In conclusion, and despite the analysts' prediction that Carrefour-Portugal and Sonae Distribuição might not be a good fit (or at least not as high as between Carrefour and other retailer, such as Auchan), the identified synergies illustrate the opposite. The triumph of Sonae in the acquisition bidding process may induce that the company already expected the realization of higher synergies than its rivals beforehand, in line with Barney's (1988) arguments. In fact, for Sonae this acquisition was considered crucial to consolidate its market leadership and all efforts were made to win the bidding process with a very competitive offer.

3. Integration Aspects

"Many acquisitions fail because aspects concerning people are disregarded." – Nuno Jordão.[32]

For potential synergistic gains to be converted into real value, some changes are necessary to make for the two companies work as a unit. As pointed out by several authors, strategic fit is not enough and the integration process is a crucial aspect on determining the success of an acquisition (e.g., Hitt, Ireland and Harrison, 2008; Cartwright, 2005; Haspeslagh and Jemison, 1991). Zollo and Singh (2004) define the integration process as a process "focused on extracting the gains associated with the combination of the two organizations" (p. 1235), Pablo (1994) adds: "[It is the] making of changes in the functional activity arrangements, organizational structures and systems, and cultures of combining organizations to facilitate their consolidation into a functioning whole" (p. 806).

As previously described, Sonae Distribuição took several measures to make this acquisition a successful deal. The dominant organizational integration strategy was to convert two companies into a single one, in order to take advantage of the synergies identified. Despite involving higher costs and risks, a high level of integration allows for a more effective realization of potential value (e.g., Zollo and Singh, 2004; Capron, 1999). An effective knowledge transfer requires the integration and interaction of the firms (e.g., Larsson and

[32] Sonae Distribuição, op. cit., p. 4.

Finkelstein, 1999; Ranft and Lord, 2002). When the acquired company is more autonomous, their interaction are more limited and, consequently, embedded knowledge will hardly be transferred between companies, jeopardizing some synergy creation.

The successful and quick integration process, with the conversion of Carrefour's stores into *Continente* in a few days, deserves a deeper look. Sonae Distribuição's efforts to make everything run properly represent a set of best practices that should be considered. Moreover, when analyzing the possibility of acquiring Carrefour-Portugal, Sonae Distribuição already had in consideration the aspects that might favor a successful fit.

This acquisition had some characteristics that predicted an easier integration process, being those characteristics in areas where usually problems arise and determine the failure of the acquisition: culture and operational fit. First, the companies belong to the same sector, which facilitates the knowledge transfer (e.g. King et al., 2006; Hitt, Harrison and Ireland, 2001). Managers did not have to learn how to deal with a new business, making the adaptation of operations of Carrefour-Portugal to Sonae Distribuição and the realization of potential synergies an easier process. Moreover, from a cultural perspective, significant shocks were not expected. The knowledge and know-how underlying Sonae Distribuição's strategy came from the strategic alliance with Promodés. Therefore, the company shared with Carrefour the same French retail tradition and way of doing business.

Schweiger and Walsh (1990) point out that effective human resource management is likely to be the key to M&A success during the post-acquisition integration process. Marks and Mirvis (2001) refer that acquisitions cause a great uncertainty to employees about their future career, which contributes to their resistance and has a negative impact on productivity, absenteeism, turnover, job satisfaction and resistance to change, jeopardizing value creation. Taking a closer look at the integration process carried out by Sonae, it is possible to identify a great concern with issues related to the integration of people, namely through the stimulation of a cooperative environment and effective communication.

The creation of a multidisciplinary team enhanced a cooperative environment between both companies. It minimized the problems arising after the acquisition by reducing employee resistance and smoothing the transfer of the embedded corporate knowledge, which makes the fit of systems and cultures and the synergy realization more likely to occur (e.g., McEvily and Marcus, 2005; Hitt, Ireland and Harrison, 2008). Despite having imposed a significant range of its policies, the cooperation that Sonae tried to induce between employees (e.g. employees received training to help the integration of Carrefour's employees) and the adoption of some of Carrefour's procedures smoothed the impact of the transition and minimized the inferiority feeling that the acquired firm employees usually feel (e.g., Hambrick and Cannella, 1993).

Effective communication also explains the absence of employee resistance. By communicating all the decisions and changes to their employees, Sonae created a feeling of belonging and involvement in the corporate change they were undertaking, in line with the literature findings (e.g., Cartwright, 2005; Hitt, Ireland and Harrison, 2008). By promptly informing that there would not be any lay-offs and explaining how the process would affect the employees' careers, they contributed to increase the employees' commitment to the success of the merger. A survey made after the integration process confirmed: people consider that the process was transparent; they were heard and felt well-integrated in the new company. As in every M&A, some people preferred to leave, but the meritocracy criteria adopted, the vast opportunities to integrate people in the company (or in other companies of the Sonae group) and the benefits program created good conditions to retain key-people and, thus, the embedded knowledge.

It is also important to bear in mind the focus on consumer satisfaction. Some M&A fail because employees are more concerned with their future positions than serving their customers, and thus, it represents a good opportunity for competitors to gain market share. To what this case is concerned, Sonae offered additional training to sales force in order to prepare them to correctly inform customers of the implications of the acquisition and to create on them the idea that the newly formed company will be even better than the previous ones in quality, prices and variety. Nuno Jordão's quote perfectly illustrates this concern: "We are aware that it is possible that some turbulence might occur during the first three or four weeks, which can result in the dissatisfaction of this or that client. Everything is going to be done to minimize those cases and to explain them to the client".[33]

The most significant difference between Carrefour and Sonae Distribuição was related to their structure and logistics. Being a global player, the decentralized structure of Carrefour has long been considered one of its main competitive advantages due to the fact that it allows the company to adapt to different market realities. On the other hand, Sonae Distribuição's operations are mainly concentrated in Portugal, a small and relatively homogeneous market, the reason why a centralized structure seems to be appropriate and allows the company to obtain high levels of efficiency. With the deal, Carrefour-Portugal is no longer part of a global chain, and thus the decentralized structure does not represent a significant competitive advantage. Therefore, its integration with Sonae Distribuição's stores seems to be the best way to obtain the identified synergies with economies of scale and scope, elimination of duplicated functions, and enlargement of Sonae's food and non-food concepts.

It can be assumed that the similar business approaches made the integration and conciliation of procedures, systems and strategies easier. In fact, both relied on close relationship with customers, innovative offering, wide and diversified product-mix, and aggressive price positioning. Nuno Jordão points out, "[t]his process should be considered a case-study"[34], and adds "[t]oday we are a single company with everyone doing their best to give to our wide customer base additional reasons for satisfaction".[35]

[33] Sonae Distribuição, op. cit., p. 4.
[34] Sónia Peres Pinto, op. cit., p. 4.
[35] Sonae Distribuição, op. cit., p. 4.

4. The Reasoning Behind the Merger

Why was an acquisition a good strategic move?

To better understand this acquisition, the sector's background and competitive environment cannot be disregarded. Carrefour's withdrawal represented the exit of an important player and, as a result, growth opportunities for the remaining players. Had Sonae not managed to buy Carrefour-Portugal, its leadership could have been threatened. Jerónimo Martins was in a good position to reach Sonae Distribuição's position and even the other retailers could use the acquisition to expand their growth pace and threaten Sonae's leadership in some markets.

Behind this strategic decision was also the desire to gain even more scale. Sonae Distribuição is a firm "designed to grow", but tied in a mature market with strict growth restrictions. In 2006, *Continente* sales area only grew 3% (4,000 sqm), a low value when compared with smaller formats growth. The acquisition could easily represent a 17% increase in sales area and a 16% increase in turnover per year, approximately, which organically would be hardly achievable in a mature market.

The increase in scale also represented an opportunity to enjoy larger profit margins by obtaining efficiency gains in economies of scale and scope and strengthening of its bargaining power towards suppliers. With the acquisition, Sonae guaranteed some ground between itself and its rivals, reaffirming itself as the number one retailer, turning into an important client for producers, and further reinforcing its competitiveness in international sourcing. In a market where consumers' purchasing choices rely on prices, this increased capacity to guarantee good profit margins without increasing final prices represents an important competitive advantage.

How does the acquisition of Carrefour-Portugal fit Sonae Distribuição's strategy?

Carrefour-Portugal represents an attractive target for Sonae due to its capacity to complement Sonae Distribuição's flaws in terms of product and store portfolios.

The integration of Carrefour's operations offered the possibility of entering new regional markets and achieving leadership in some of them, which was not possible without the deal due to legal restrictions. It is important to bear in mind that the integration of Carrefour's stores did not only result in the expansion of the food segment (where growth restrictions are stricter) but also in the non-food segment. Store restructuring under Sonae Distribuição's space organization system made it possible to open new non-food stores in the same infrastructures, making a clear contribution to the growth of these concepts.

On the other hand, the deal contributed to reinforce the commitment of Sonae with having a vast product offering. New product categories were included in Sonae's product portfolio and some of the products were substituted for higher quality ones. The long tradition of Carrefour in private labels also brought benefits to Sonae. The Portuguese company was already aware of the importance and acceptance of these products by consumers and a program to reinforce

Continente's private label was already in course before the deal. Now Sonae could benefit from Carrefour's larger private label supplier network and from its know-how in this area.

Despite being considered too small and non-strategic for Carrefour, Carrefour-Portugal was present in important locations, had a significant increase in sales area and registered good sales per store results. Its integration in Sonae could impulse the development of Carrefour-Portugal by being integrated in a larger Portuguese-based chain and augmenting the reach of its products. The good results that Carrefour was able to achieve even with a weaker brand and lower levels of consumers' global satisfaction show that Sonae can learn with these new employees and incorporate some of the best practices used by the global Carrefour chain.

The perfect fit in terms of culture and organization reinforces the idea that Carrefour was the perfect target for the acquisition. The same French-experience background and similar strategic objectives allied with a highly organizational and operational fit made it possible to realize the expected synergies.

It is therefore possible to conclude that the acquisition of Carrefour-Portugal fits Sonae Distribuição's strategic pillars perfectly. First, it offers an immediate growth in terms of sales volume and sales area, and allows for the opening of new non-food stores. Therefore, it makes it possible for Sonae to reinforce its position in the Portuguese market, obtaining a stronger cash-flow generation that can serve as basis for organic growth, diversification and internationalization. Second, the larger scale allows for superior gains in terms of efficiency, through economies of scale and enhancement of bargaining power. Third, the integration of new knowledge and competences reinforces Sonae's capability to constantly innovate, namely with new products, new practices, new ways of serving the client, etc. In fact, the acquisition impelled Sonae to allocate additional funds to investigation and product innovation.

Results

"In particularly adverse market conditions, Sonae Distribuição progressed over an already prominent leadership position in the Portuguese retail market, and safeguarded the demanding equilibrium between growth and operational profitability. […] In the current context, the results for 2008 hereby confirm the Company´s capacity to, sustainably, generate value for all its stakeholders. - Nuno Jordão.[36]

Since Sonae Distribuição did not disclose specific quantitative results regarding the acquisition of Carrefour-Portugal, and it is not possible to isolate the impact of the deal from other investments that Sonae carried out, it is not feasible to make an in-depth analysis of the impact of this deal on the company's performance. Moreover, data regarding market shares is not available yet to analyze the impact on market share.

According to Sonae Distribuição's 2008 financial report, the main synergies were accomplished. The weaker operational margin values registered in the beginning of the year as

[36] Sonae Distribuição, 2008 Earnings Announcement – Consolidated Results, 18 Mar. 09

a consequence of the integration of Carrefour were overcome. In only one year, the company was able to improve efficiency in ex-Carrefour stores, surpassing the operational margin levels registered in the previous year in the food segment and maintaining the levels of total EBIDTA margin (excluding fuel) unchanged[37]. Thus the objective of having a balance between growth and operational profit was achieved.

Despite 2008 having registered a decrease in private consumption (mainly affecting non-food segments), the total turnover of the company increased about 25% (20% without petrol stations). Considering that like-for-like sales only increased 1%, it seems possible to conclude that the integration of Carrefour stores had a significant contribution. The extended food and non-food sales area and the product-mix reinforcement (namely private labels, whose weight in total sales increased 2%) can be identified as the main reasons behind this growth. The impact is essentially evident in *Continente* sales, which increased 36% (being like-for-like sales increase of only 1%), against a growth of 2% registered in 2007. It seems important to note that besides the acquisition, the company continued its organic growth projects, which explain part of the financial results (consult Exhibit 10 for further information).

In conclusion, only one year after the acquisition and with a net profit still negatively influenced by the higher financial costs caused by the acquisition, the results point out to this being a successful deal. The required 0.5% increase in operational cash-flow during the first three years seems to be easily achievable, paying off the investment. The sales volume increase and operational margin improvement already registered substantiate this conclusion.

CONCLUSION

Creating and realizing synergies is a long process that does not end with the identification of potential synergies. Several aspects must be taken into account when an acquisition is being made, namely the strategic fit between the companies and the measures taken during the post-acquisition integration process to convert potential synergies into real value.

This case perfectly illustrates an acquisition made in the pursuit of growth and scale in a mature market, where growth rates are limited. These aspects are crucial in retailing given the specific characteristics of the market, based on low margins, large sales volumes and legal growth restrictions. The fact of being a mature market with too many players puts even more pressure on prices, shrinking profit margins. M&A were then expected to happen and this deal seems to represent the beginning of that process.

This acquisition can be seen as the consolidation of Sonae Distribuição's market leadership, with all the advantages embedded in that. The increased scale and market dominance created new opportunities for gains of efficiency, due to a higher turnover and reinforced bargaining power. Being a leader has also an impact on brand image and reputation, facilitating its

[37] The company also implemented efficiency enhancement programs, which explain part of the results.

penetration in the market, customer loyalty and the diffusion of Sonae's own labeled products. More than contributing directly to Sonae's growth, the merger reinforced the base for future organic growth, adding new licenses to Sonae's portfolio and new space where the company can establish new non-food business concepts. The additional value creation also boosts the necessary cash-flow base for internationalization in which the firm is nowadays involved.

It is possible to identify strategic fit as one of the main reasons behind the creation of value. Sonae Distribuição and Carrefour-Portugal demonstrate a significant level of complementarity, namely in store and products portfolios and knowledge. Complementarities are the main source of sustainable synergies since they allow the creation of a unique combination of resources that rivals can hardly replicate or compete against. Therefore, Sonae Distribuição was able to create a stronger product portfolio, with more categories and higher quality products, namely its own private label. In terms of stores, the entrance in new regional markets and the access to new privileged locations was possible. The knowledge sharing is also crucial to create value in this acquisition by creating a stronger knowledge and know-how base, crucial to be a step ahead of competition in satisfying consumer preferences.

In addition, this case study presents a range of best practices during the integration process. Human resources were identified as a key aspect that could not be disregarded. Thereby conflicts and uncertainty were prevented by focusing on cooperation and communication. The company tried to involve every employee in the integration process, communicating all the decisions and the consequences for their future, in order to make them feel committed with the success of the process. Managers tried to unify from the beginning both company teams, to facilitate the transfer of embedded knowledge and establish the best policies to make the new company succeed. Efforts were made for the process to develop as quickly as possible, making the necessary changes to fully gather the synergistic gains, namely through structure reorganization and knowledge sharing.

This case also demonstrates the positive impact on an integration process of having a similar culture and belonging to the same business segment. The common French-retailing background explains the similar cultures of Sonae Distribuição and Carrefour, determining their similar ways of facing retail business. Therefore, despite some differences that required adjustments, there was a substantial operational fit between these two companies, which made the integration process easier. Since significant changes are not necessary, cultural shocks and employee resistance were not expected.

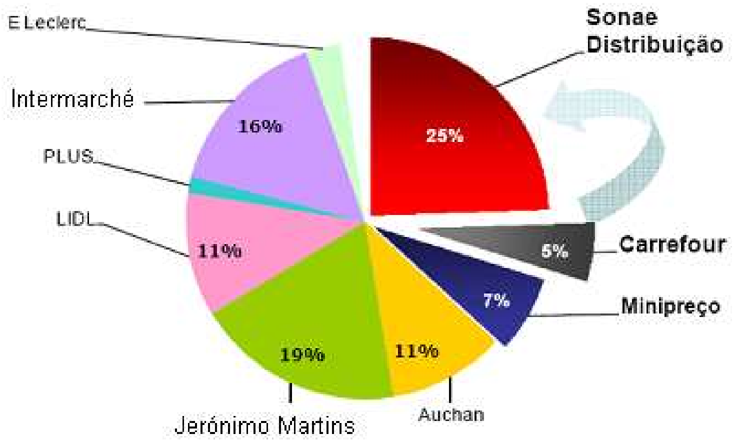
Even only after one year of post-acquisition operations, the analysis of this case indicates that this strategic move shows evidence of this having been a success case on creating value. Contrary to several analyst expectations, in the first year turnover registered a 25% increase, operational margins registered an improvement regardless of the integration of Carrefour stores and the introduction of new product references boosted sales. Therefore, this acquisition reinforced Sonae Distribuição's position as the *cash-cow* of Sonae SGPS.

Exhibit 1 - Retail formats definition:

- **Traditional retailers:** usually with small dimension, they charge higher prices than modern retailing to compensate the low quantity sold.
- **Supermarkets:** with a store space between 400 sqm and 2,500 sqm, they offer food and household products organized into departments.
- **Hypermarkets:** with a store space larger than 2,500 sqm, they combine under the same roof a supermarket and a department store.
- **Discounts:** with small/medium dimension (400 to 1000 sqm), they present a lower number of SKUs (600 to 1000), usually selling mostly their private label products. The strategy is based on minimization of all costs that do not add value, in order to minimize prices (20 to 40% lower) and maximize sales.

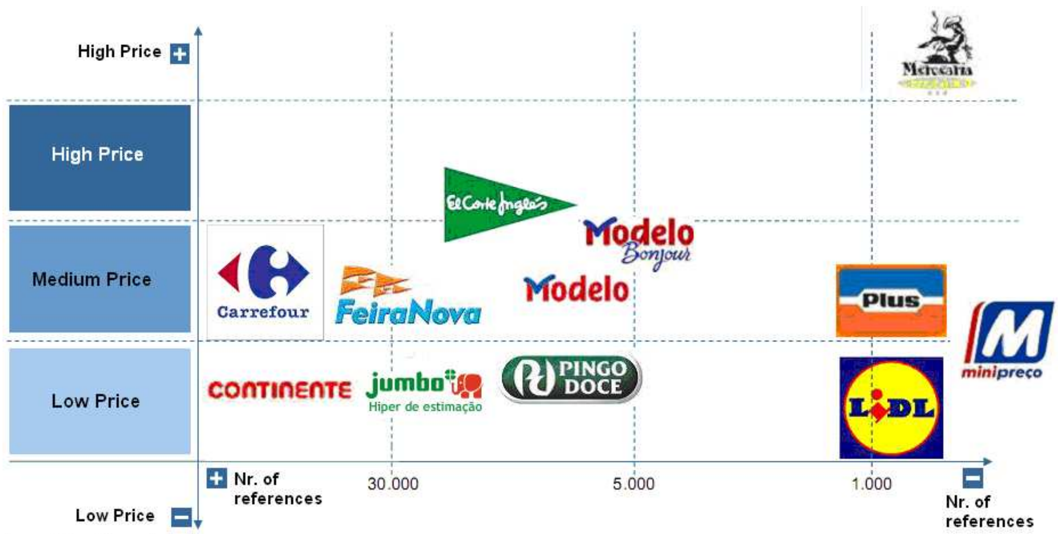
Source: adapted from Rousseau, 2008.

Exhibit 2 – Portuguese retailing before the acquisition



Source: Sonae Distribuição

2.1 – Retailers' market shares in the food segment



Source: Roland Berger Analysis http://www.aped.pt/pdf/roland_berger.pdf

2.2 – Retailers positioning. Both *Continente* and *Carrefour* were focused on variety. *Continente* and *Modelo* belong to Sonae Distribuição, *Feira Nova* and *Pingo Doce* belong to Jerónimo Martins, and *Jumbo* belongs to Auchan. Intermarché's brands are not represented in this analysis.

Exhibit 3 – APED rankings[38]

- Top 10 Sales Volume

Million Euros	2006	2005	2006 vs. 2005
1º Sonae Distribuição	3.526	3.115	+13%
2º Jerónimo Martins	1.948	1.752	+11%
3º Auchan	1.194	1.145	+4%
4º Lidl	1.050*	972*	+8%*
5º	705	655	+8%
6º Carrefour	505	498	+1%
7º	339	297	+14%
8º	290	220	+32%
9º Staples	173	129	+34%
10º	154	132	+17%

- Top 10 Sales Area

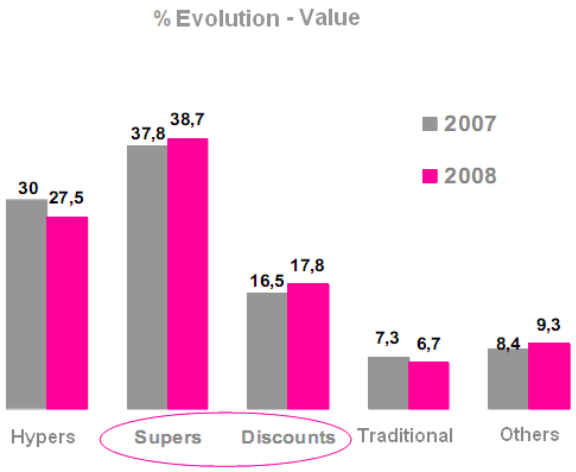
Thousands m²	2006	2005	2006 vs. 2005
1º Modelo	187	169	+10%
2º Lidl	176	159	+11%
3º Pingo Doce	172	159	+8%
4º Continente	162	158	+3%
5º FeiraNova	150	131	+15%
6º Auchan	126	126	0%
7º	120	98	+22%
8º	90	48	+88%
9º Carrefour	83	68	+22%
10º worten	63	55	+15%

- Top 10 Number of Stores

Nr. of Stores	2006	2005	2006 vs. 2005
1º	384	351	+9%
2º Pingo Doce	202	191	+6%
3º Lidl	182	162	+12%
4º Modelo	105	95	+11%
5º worten	87	74	+18%
6º modalfa	70	58	+21%
7º	64	50	+28%
8º	48	41	+17%
9º Salsa	44	32	+38%
10º	42	45	-7%

Source: APED, Ranking 2006

Exhibit 4 - Formats evolution: 2007-2008



Source: TNS Worldpanel 2009 "O Consumidor e a Distribuição". 12 Feb. 09

4.1 – Hypermarkets are losing their dominance to supermarkets and discounts

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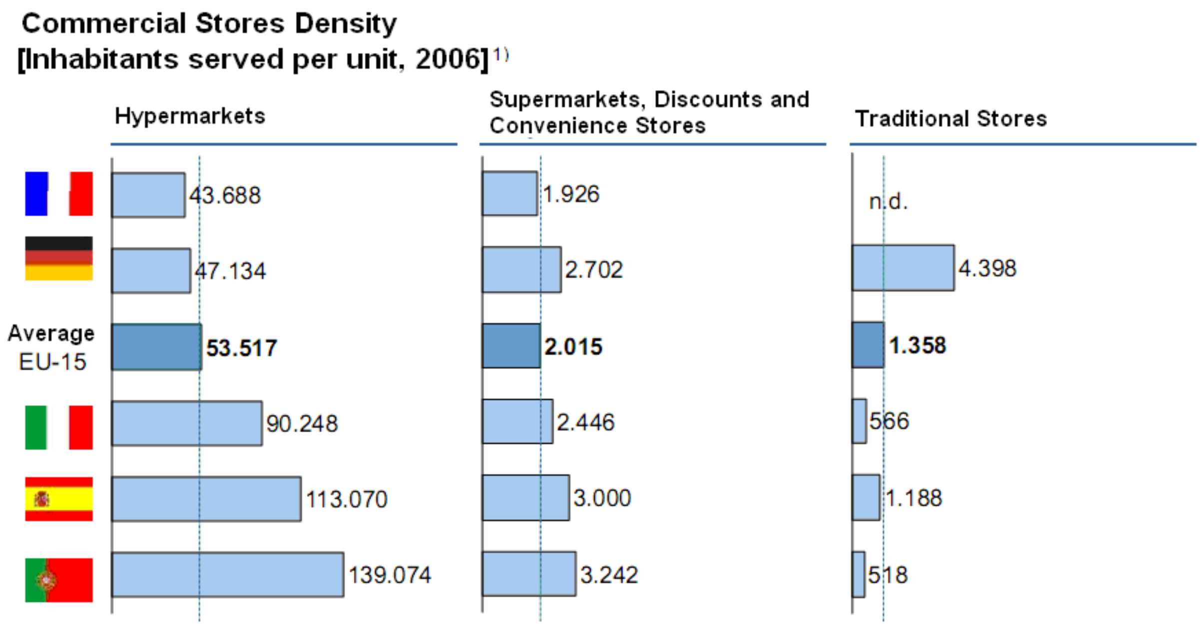
38 Rankings do not include Intermarché, since it only integrated APED in 2008.

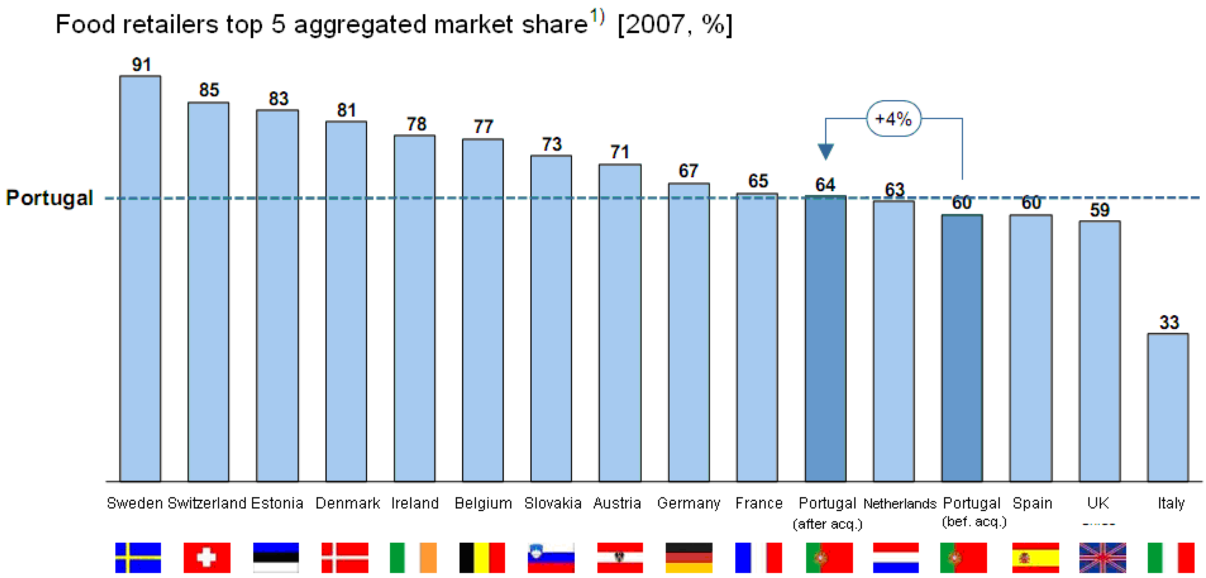
Exhibit 5 – Concentration in the Portuguese Retail Sector



1) Traditional Stores are the ones with an area below 100 sqm
Source: Eurostat, Euromonitor, AC Nielsen, Roland Berger analysis http://www.aped.pt/pdf/APED_Conferencia_Imprensa.pdf

5.1 – When compared with other European countries we can see that there is still growing opportunities for modern retailing, namely hypermarkets, supermarkets and discounts.

Exhibit 6 – Concentration in the Portuguese retail sector



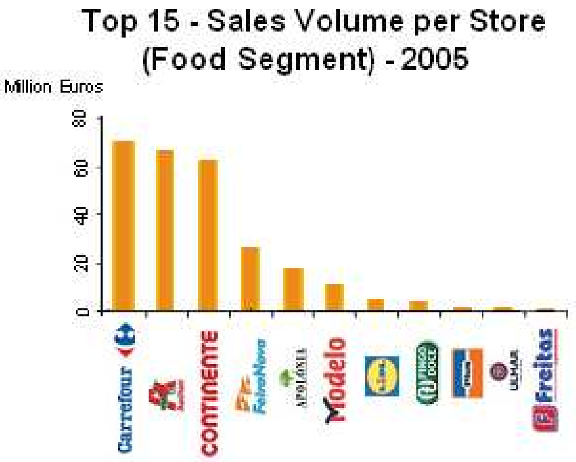
1) Market shares of Switzerland, Denmark, Belgium and the Netherlands correspond to 2006
Source: APED, Planet Retail, Roland Berger analysis http://www.aped.pt/pdf/APED_Conferencia_Imprensa.pdf

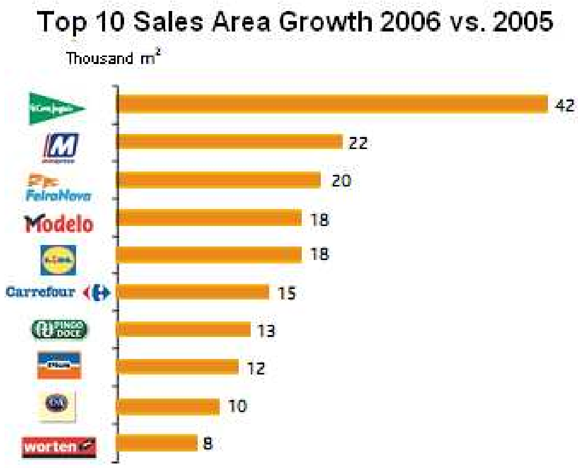
6.1 – Portugal is below the European average regarding retailing concentration

Exhibit 7 – Carrefour-Portugal before the deal

Source: Sonae Distribuição, APED

7.1 – Carrefour was an important retailer, despite not being able to achieve a leading position





Source: APED – Ranking 2005 and 2006

7.2 –Carrefour was the number one retailer in sales volume/store in 2005 and the 6th in sales area growth in 2006.

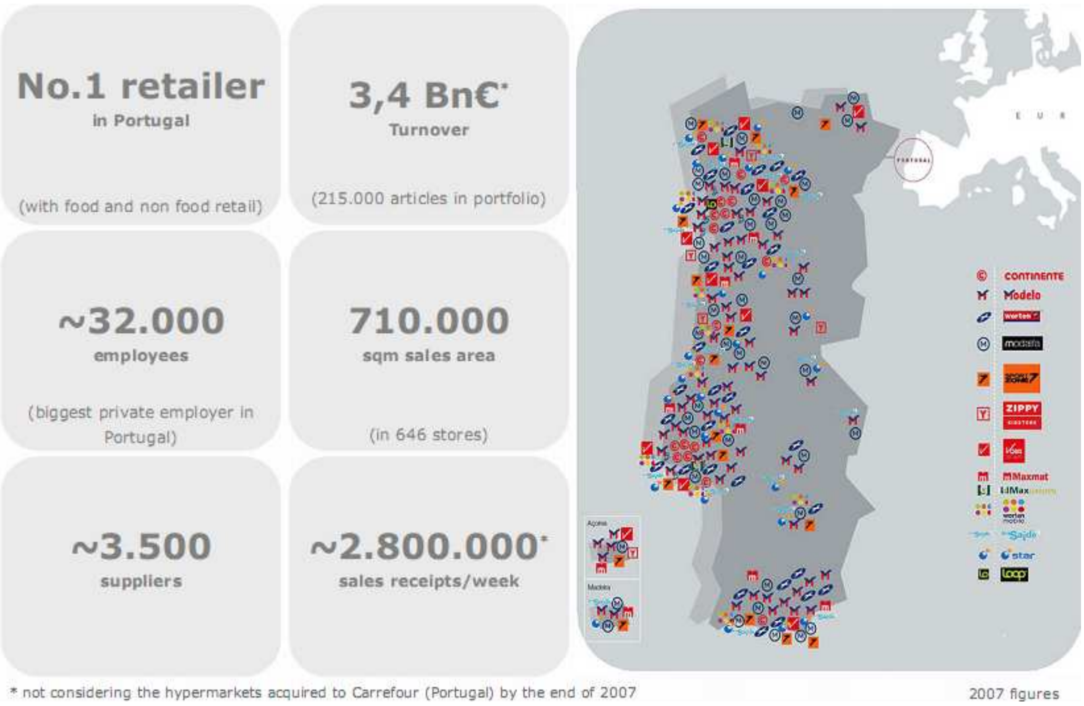
Exhibit 8 – Consumers' satisfaction with retailers, March 2007

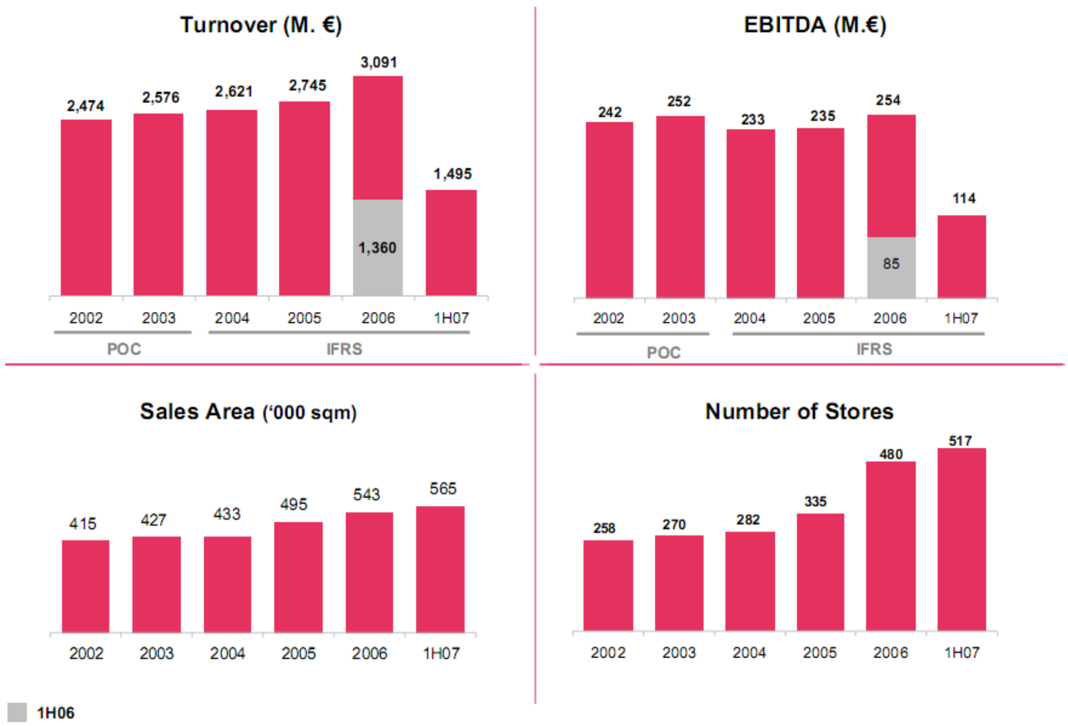
	Carrefour	Continente	Modelo	Intermarché	Jumbo	Feira Nova	Minipreço	Lidl	Pingo Doce
Global Satisfaction	66.7	73.2	72.6	69.2	84.6	74.7	75.4	78.5	67.3
Information	60.4	71.3	61.4	62.4	72.6	55.7	65	70.9	51.7
Price-quality Relationship	52.1	57.6	52.4	59.0	69.0	65.8	70.2	75.9	56.8
Fresh Products Quality	60.4	58.1	59.5	62.4	66.7	68.4	40.3	50.7	58.6
Brand Variety	68.8	77.8	58.8	63.3	77.4	76	33.8	43.1	37.1
Products Variety	77.1	83.7	66.7	70.1	78.6	87.3	53.3	60.8	42.3
Price	41.6	50.3	41.2	46.2	58.4	46.9	75.4	74.7	45.7

Source: Marktest <http://www.marktest.com/wap/a/n/id~d57.aspx>

8.1 – Carrefour was considered by consumers as having a vast diversity of products and brands and better quality in fresh products than Sonae Distribuição brands (*Continente* and *Modelo*).

Exhibit 9 – Sonae Distribuição before the deal*





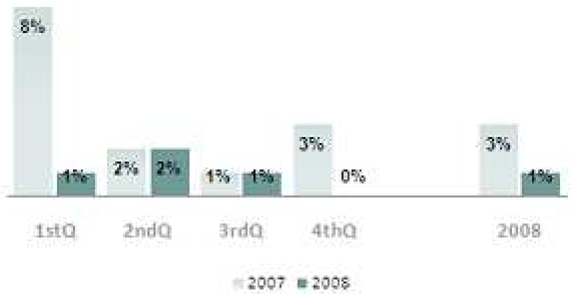
Source: Sonae Distribuição

***Note: SD's portfolio is presented in Appendix 8.**

Exhibit 10 – Sonae's results after the deal*

Evolution of food formats EBITDA margin

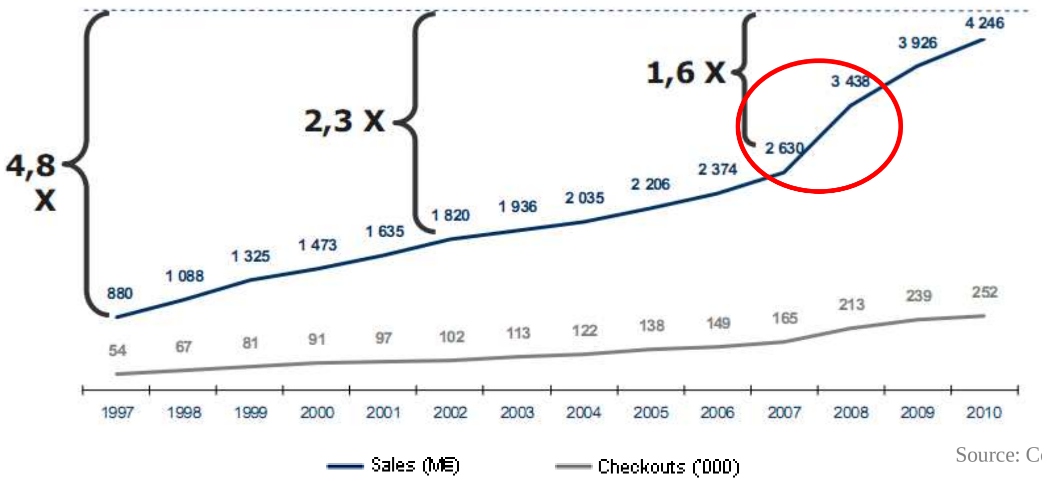
L4L evolution of food formats



Source: Sonae Distribuição

10.1 – Despite the initial negative impact of the acquisition on the operational margin, the company was able to improve in the first year. The evolution of like-for-like sales only explains a small part of the sales increase in 2008, which means that the acquisition had an important impact.

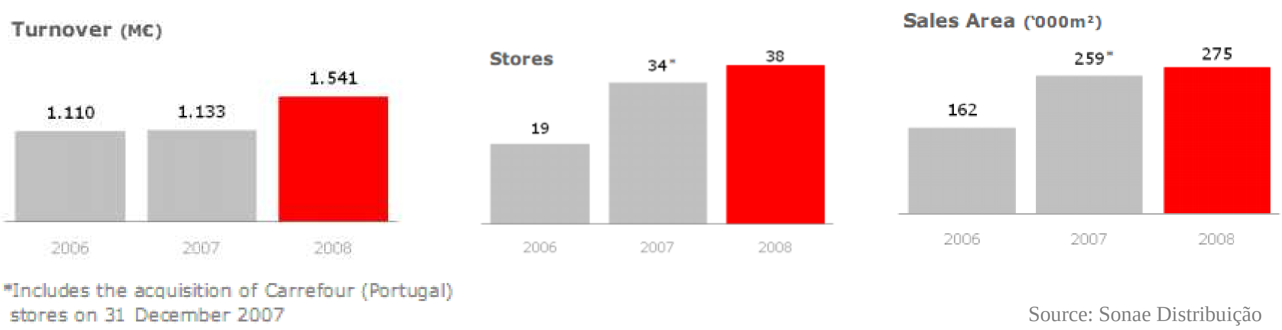
Sonae Distribuição Sales Evolution



Source: Cotec Portugal

10.2 – Looking at the sales evolution of the company, is possible to identify a clear leap in sales after the acquisition of Carrefour-Portugal.

***Continente* Results**



Source: Sonae Distribuição

10.3 – *Continente*, the brand who suffered a higher impact with the acquisition, registered an important expansion as a result of the acquisition.

***Note: financial results of Sonae Distribuição are presented in Appendix 10.**

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APPENDIXES

Appendix 1 - Economic Concentration of Top 10 retailers

- **Evolution: 2000-2005**

Year	Top 10 Retail Sales**	Share of Top 250*	Share of Top 200
2005	885	29.40%	30.90%
2004	817	28.80%	30.20%
2003	740	28.40%	29.80%
2002	650	N/A	29.20%
2001	634	N/A	29.60%
2000	576	N/A	27.40%

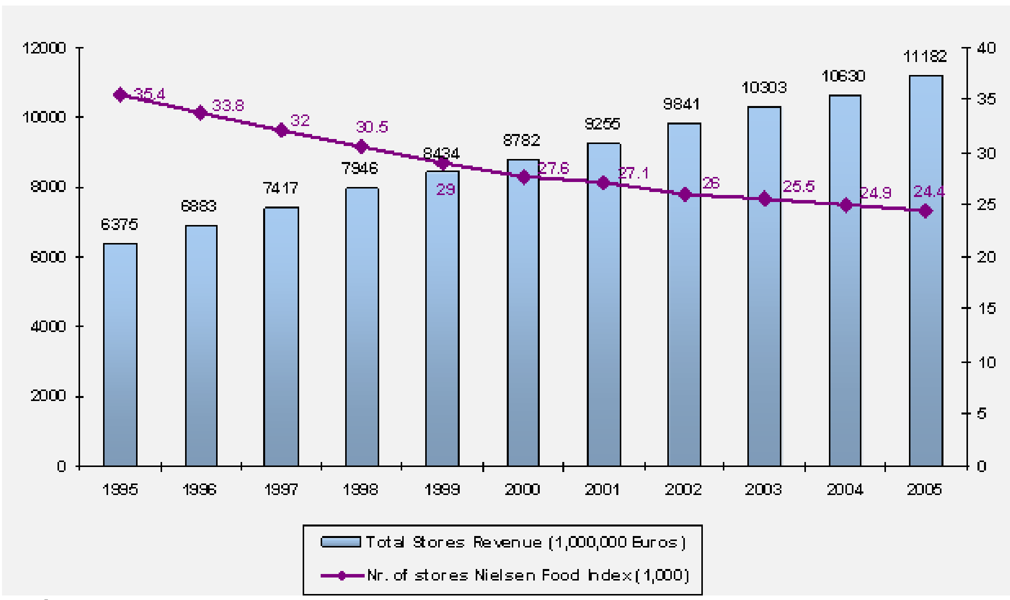
Sources: published company data and Planet Retail

- **Situation in 2007**

Top 250 rank	Name of company	Country of origin	2007 retail sales (U.S.$mil)	2007 Retail sales growth
1	Wal-Mart	U.S.	374,526	8.6%
2	Carrefour	France	112,604	5.5
3	Tesco	UK	94,740	10.9
4	Metro	Germany	87,586	7.2
5	Home Depot	U.S.	77,349	-2.1
6	Kroger	U.S.	70,235	6.2
7	Schwarz	Germany	69,346	12.7
8	Target	U.S.	63,367	6.5
9	Costco	U.S.	63,088	7.0
10	Aldi	Germany	58,487	5.7
		Top 10*	1,071,328	7.2%
		Top 250*	3,619,257	7.6%
		Top 10 Share of Total	29.6%	

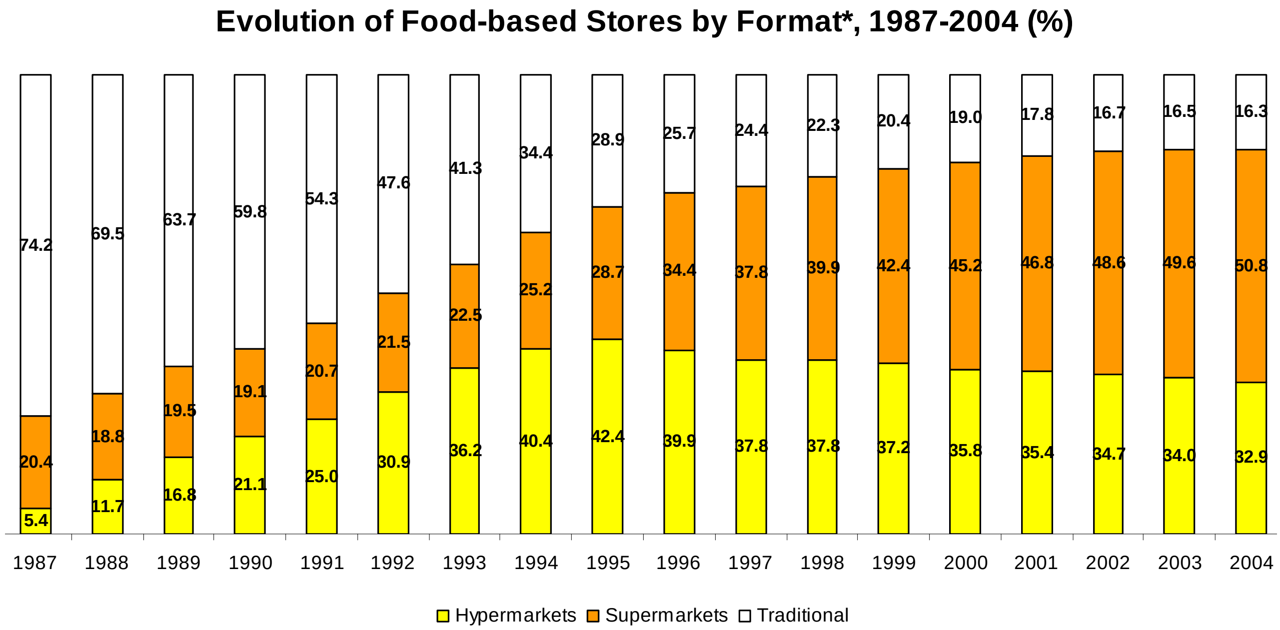
Source:
Deloitte - Global Powers of Retailing 2007 - www.deloitte.com/dtt/cda/doc/content/Global%20Powers%20of%20Retailing_07(3).pdf
Deloitte - Global Powers of Retailing 2009 – http://public.deloitte.com/media/0460/2009GlobalPowersofRetail_FINAL2.pdf

Appendix 2 – Portuguese retailing evolution (Food Segment)



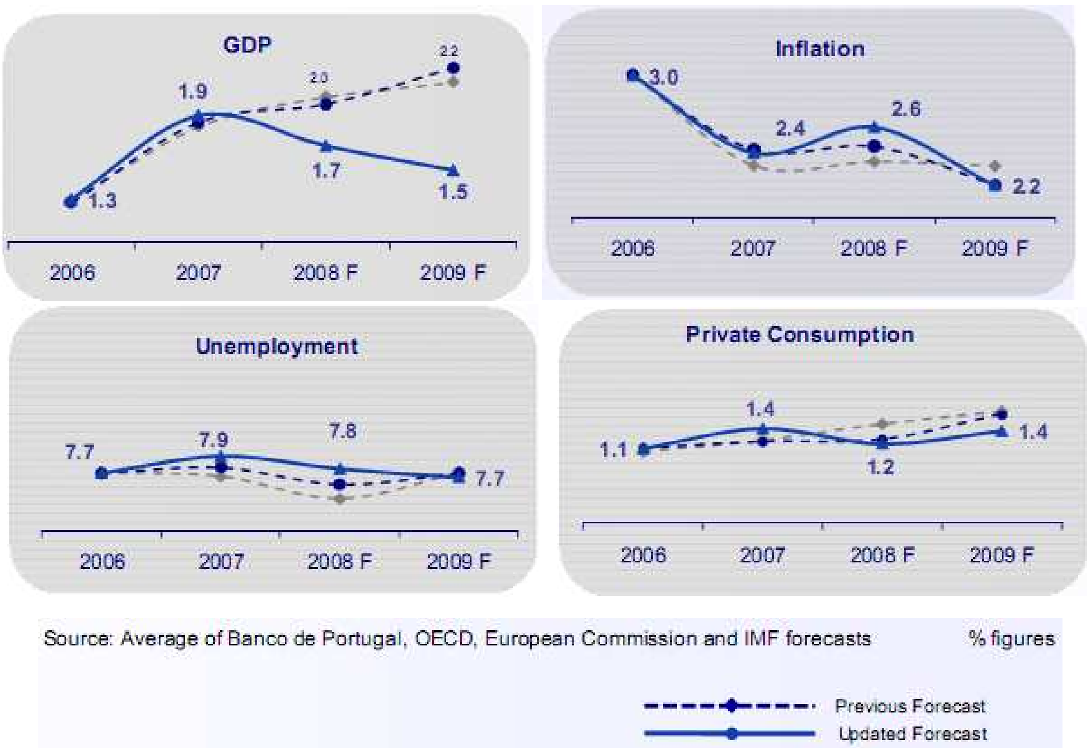
Source: A.C. Nielsen

Appendix 3 - Retail formats evolution



* Percentage of sales in Nielsen Food Index
Source: ACNielsen, ES Research – Research Sectorial.
http://www.bes.pt/SiteBES/cms.aspx?plg=22af9c17-74b2-4f38-9c95-96f1df63703a

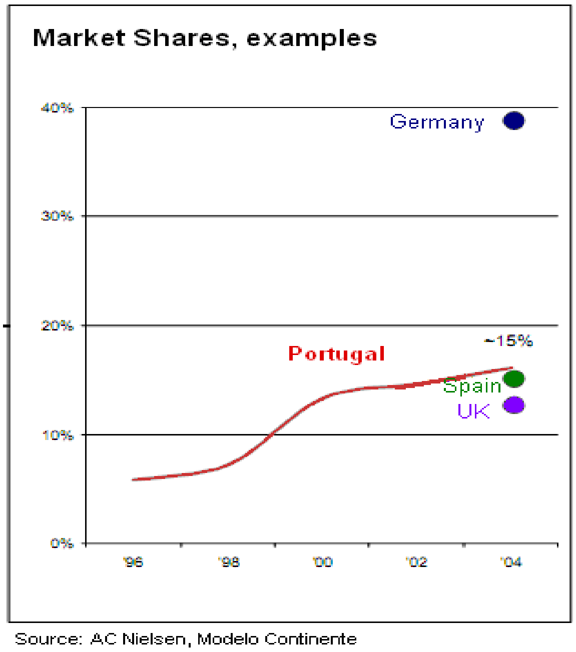
Appendix 4 - Portuguese economy trends



Source: Sonae SGPS Management Presentation 1Q08 – June 2008

Appendix 5 - Discounts in Portugal

- Discount Evolution in Portugal

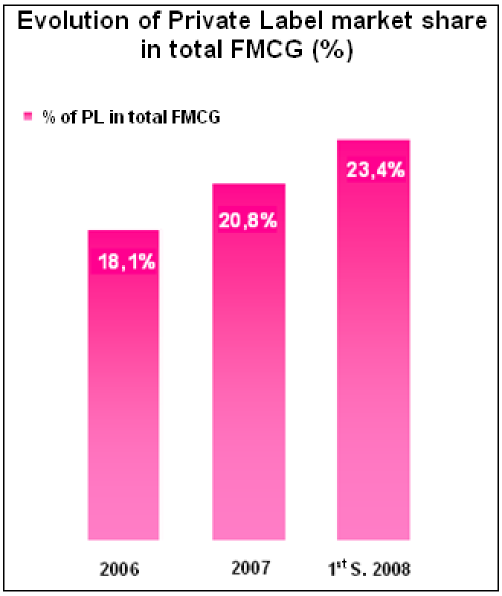


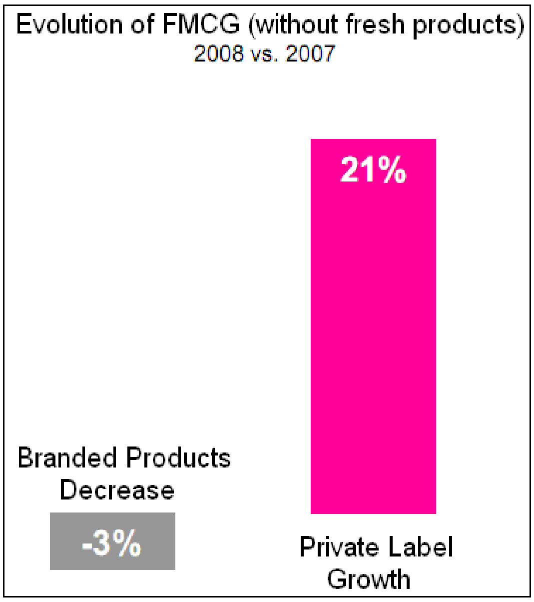
Source: www.sonae.pt - Apresentação MBA AESE, 21 Jan. 05

- Discounts in Portugal vs. Europe

Source: A.C. Nielsen

Appendix 6 – Private Label Evolution





Source: TNS Worldpanel 2009 (Portugal) – "O Consumidor e a Distribuição". 12 Feb. 09

Appendix 7 – APED Productivity Ranking 2007

Top 10 Sales Volume per Sales Area

	(Euros)	2007	2006	2007 vs. 2006
1.		19.745	17.935	+10%
2.		15.110	19.743	-24%
3.	Sapatarias COUTINHO	12.373	N/D	N/D
4.	Salsa	11.533	10.983	+5%
5.		10.538	7.463	+41%
6.		10.509	10.713	-2%
7.		8.556	8.438	+1%
8.	worten	7.630	7.533	+1%
9.	continente	7.368	7.745	-5%
10.		7.222	N/D	N/D

* APED forecast

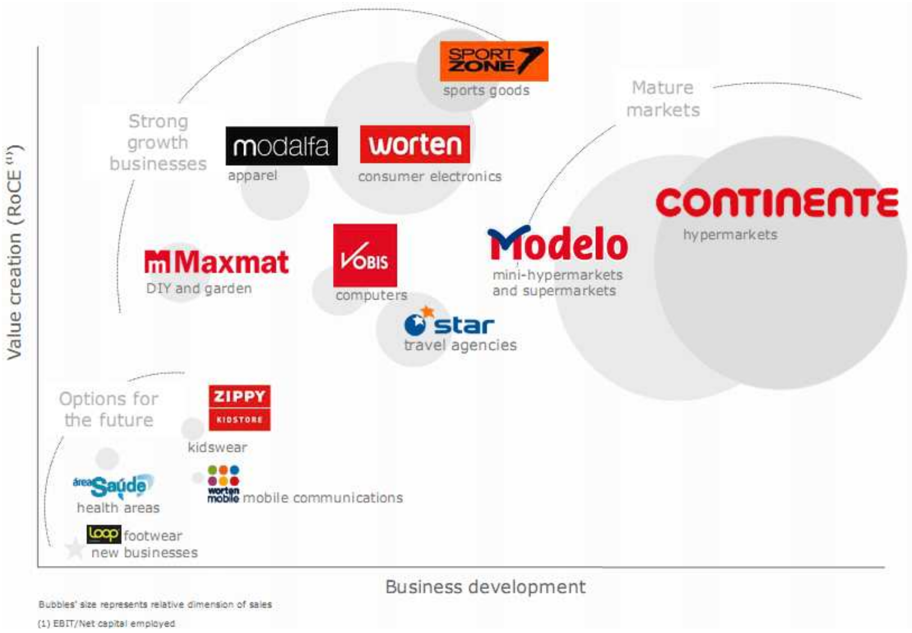
Top 10 Sales Volume per Employee

	(Euros)	2007	2006	2007 vs. 2006
1.	Lojas BABOU	289.971	307.161	-6%
2.		261.828*	265.695*	-2%*
3.		253.226	220.231	+15%
4.		233.265	244.728	-5%
5.		226.804	223.618	+1%
6.		225.807	226.744	-0%
7.		223.062	202.790	+10%
8.		221.970	242.550	-9%
9.		202.016	176.056	+15%
10.		199.791	208.314	-4%

* APED forecast

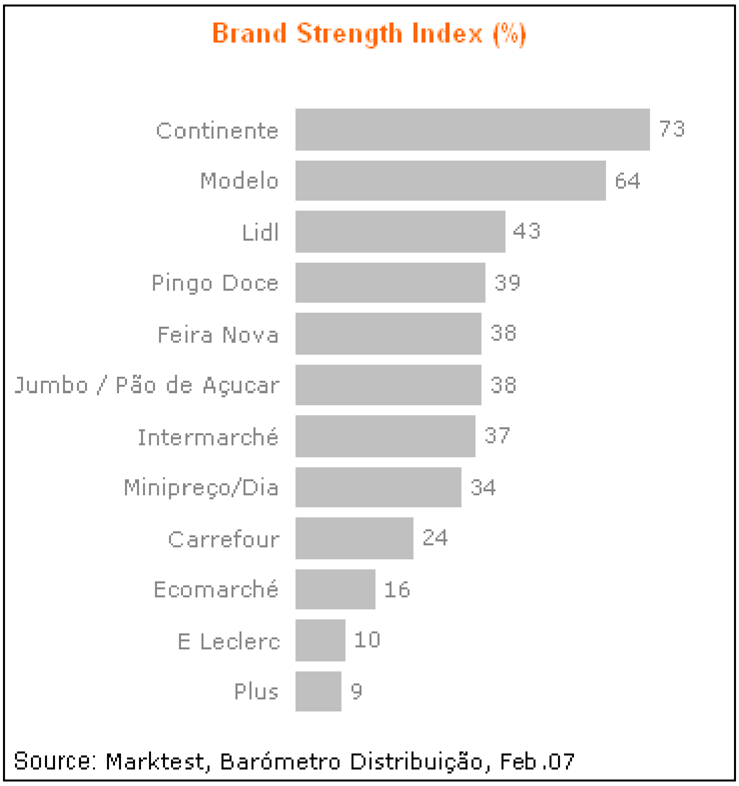
Source: APED – Ranking 2007

Appendix 8 – Sonae Distribuição Portfolio



Source: Sonae Distribuição

Appendix 9 - Ranking of brand strength in retailing



Appendix 10 – Financial Results of Sonae Distribuição, 2008

	2008		2007		change	
	M.€	% TO	M.€	% TO	M.€	%
Turnover	4,220	100	3,385	100	835	25%
EBITDA	**355**	**8.4**	**299**	**8.8**	**56**	**19%**
Amortization and depreciation	-115	-2,7	-87	-2.6	-28	32%
Provisions and others[*]	1	0,0	-1	0.0	2	-
EBIT	**240**	**5.7**	**211**	**6.2**	**29**	**14%**
Net Financial Expenses	-72	-1.7	-35	-1.0	-37	108%
Profits on Ordinary Activities	**168**	**4.0**	**176**	**5.2**	**-8**	**-4%**
Shares of results of associated undertakings and invest income	14	0.3	0	0.0	14	-
Profit before Tax	**182**	**4.3**	**176**	**5.2**	**6**	**4%**
Taxation	-11	-0.3	-7	-0.2	-4	61%
Net Profit for the Period	**171**	**4.0**	**169**	**5.0**	**2**	**1%**
Attributable to equity holders of SD	171	4.1	167	4.9	4	2%
Attributable to minority interests	0	0.0	1	0.0	-2	-

	December 2008		December 2007[1]		change	
	M.€	%	M.€	%	M.€	%
Non-current assets and assets held for sale	2,752	75%	2,448	75%	305	12%
Current Assets	919	25%	799	25%	120	15%
Total Assets	3,671	100%	3,246	100%	425	13%
Total Equity	931	25%	851	26%	80	9%
Non-current liabilities	1,349	37%	1,187	37%	161	14%
Current Liabilities	1,391	38%	1,207	37%	183	15%
Total Liabilities	2,740	75%	2,395	74%	345	14%
Total Equity and Liabilities	3,671	100%	3,246	100%	425	13%

Source: Sonae Distribuição – 2008 Earnings Announcement